Supreme Court, U.S.
FILED

96 342 AUG 30 1996

OFFICE OF THE CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1995

IN THE MATTER OF WABASH VALLEY POWER ASSOCIATION, INC.

THE UNITED STATES OF AMERICA, ON BEHALF OF THE RURAL ELECTRIFICATION ADMINISTRATION, PETITIONER

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

WALTER DELLINGER
Acting Solicitor General
FRANK W. HUNGER
Assistant Attorney General
PAUL BENDER
Deputy Solicitor General
DAVID C. FREDERICK
Assistant to the Solicitor General
WILLIAM KANTER
JOHN P. SCHNITKER
JOHN T. STEMPLEWICZ
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 514-2217

QUESTION PRESENTED

Whether the courts below erred in creating an exception to the absolute priority rule, 11 U.S.C. 1129(b)(2)(B)(ii), to enable a debtor that utilizes a cooperative form of business organization to retain control of the enterprise over the objection of a class of senior creditors, whose claims for more than $ 670 million remain substantially unpaid.

PARTIES TO THE PROCEEDING

The parties to the proceeding in the court of appeals (including related entities) include the Rural Electrification Administration (now the Rural Utilities Service) of the United States Department of Agriculture, the Indiana Office of Utility Consumer Counselor, the State of Michigan, Wabash Valley Power Association, Inc., and the following rural electric membership cooperatives: Boone County Rural Electric Membership Corporation, Carroll County Rural Electric Membership Corporation, Fruit Belt Rural Electric Cooperative, Fulton County Rural Electric Membership Corporation, Hancock County Rural Electric Membership Corporation, Hendricks County Rural Electric Membership Corporation, Jasper County Rural Electric Membership Corporation, Jay County Rural Electric Membership Corporation, Kankakee Valley Rural Electric Membership Corporation, Kosciuski County Rural Electric Membership Corporation, LaGrange County Rural Electric Membership Corporation, Marshall County Rural Electric Membership Corporation, Miami-Cass County Rural Electric Membership Corporation, Newton County Rural Electric Membership Corporation, Noble County Rural Electric Membership Corporation, Parke County Rural Electric Membership Corporation, Paulding-Putnam Rural Electric Cooperative, Steuben County Rural Electric Membership Corporation, Tipmont Rural Electric Membership Corporation, United Rural Electric Membership Corporation, Wabash County Rural Electric Membership Corporation, Warren County Rural Electric Membership Corporation,

White County Rural Electric Membership Corporation, and Whitley County Rural Electric Membership Corporation.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	2
Statutory provisions involved	2
Statement	3
Reasons for granting the petition	8
Conclusion	22

TABLE OF AUTHORITIES

Cases:

Ahlers, In re, 794 F.2d 388 (8th Cir. 1986)	11
Allen University, In re, 497 F.2d 346 (4th Cir. 1974)	17
Blum v. *Stenson*, 465 U.S. 886 (1984)	16
Case v. *Los Angeles Lumber Prod. Corp.*, 308 U.S. 106 (1939)	11, 13
City of Chicago v. *Environmental Defense Fund*, 114 S. Ct. 1588 (1994)	18
Eastern Maine Elec. Coop., In re, 125 B.R. 329 (Bankr. D. Maine 1991)	18, 20
560 Ocean Club, L.P., In re, 133 B.R. 310 (Bankr. D.N.J. 1991)	21
Lincoln Ave. & Crawford's Home for the Aged, In re, 164 B.R. 600 (Bankr. S.D. Ohio 1994)	21
Louisville Trust Co. v. *Louisville, N.A. & C. Ry.*, 174 U.S. 674 (1899)	11
Lummus Indust., Inc., In re, 193 B.R. 615 (M.D. Ga. 1996)	21
Mandalay Shores Coop. Housing Ass'n, In re, 53 B.R. 609 (Bankr. M.D. Fla. 1985)	18, 20
National Rural Utils. Coop. Fin. Corp. v. *Public Serv. Comm'n on Ind.*, 552 N.E. 2d 23 (Ind. 1990)	4
National Rural Utils. Coop. Fin. Corp v. *Wabash Valley Power Ass'n*, 111 B.R. 752 (S.D. Ind. 1980)	4

Cases—Continued: Page

Northern Pacific Ry. v. *Boyd*, 228 U.S. 482 (1913) 15
Norwest Bank Worthington v. *Ahlers*, 485 U.S. 197 (1988) 7, 8, 9, 11, 12, 14, 15
Russello v. *United States*, 464 U.S. 16 (1983) 17
S.A.B.T.C. Townhouse Ass'n, In re, 152 B.R. 1005 (Bankr. M.D. Fla. 1993) 18
Stgall, In re, 85 B.R. 510 (C.D. Ill. 1981), aff'd, 869 F.2d 140 (7th Cir. 1989) 14
Toibb v. *Radloff*, 501 U.S. 157 (1991) 16, 17
Two-KMF Development Ass'n, In re, 63 B.R. 149 (Bankr. N.D. Ill. 1985) 21
Unruh v. *Rushville State Bank*, 987 F.2d 1506 (10th Cir. 1993) 14, 15
U.S. Bancorp Mortgage Co. v. *Bonner Mall Partnership*, 115 S. Ct. 386 (1994) 8
Wabash Valley Power Ass'n, In re, 117 B.R. 613 (S.D. Ind. 1990) 4
Wabash Valley Power Ass'n v. *REA*, 903 F.2d 445 (7th Cir. 1990) 4
Wabash Valley Power Ass'n v. *REA*, 988 F.2d 1480 (7th Cir. 1993) 4
Westchester County Civil Serv. Employees Ass'n, In re, 111 B.R. 451 (Bankr. S.D.N.Y. 1990) 21
Whittaker Memorial Hosp. Ass'n, Inc., In re, 149 B.R. 812 (Bankr. E.D. Va. 1993) 17-18, 20

Statutes and regulations:

Bankruptcy Code, 11 U.S.C. 101 *et seq.*:
11 U.S.C. 101(9) 16
11 U.S.C. 101(13) 16
11 U.S.C. 101(41) 16
11 U.S.C. 109(d) 16
11 U.S.C. 1112(c) 17
11 U.S.C. 1124(a) 10
11 U.S.C. 1126(a) 5

Statutes and regulations—Continued: Page

11 U.S.C. 1129(a)(8) 10
11 U.S.C. 1129(b) 10, 18
11 U.S.C. 1129(b)(1) 10
11 U.S.C. 1129(b)(2)(B) 12
11 U.S.C. 1129(b)(2)(B)(i) 11
11 U.S.C. 1129(b)(2)(B)(ii) 5, 8, 11, 15, 17
The Federal Crop Insurance Reform and Department of Agriculture Rorganization Act of 1994, Pub L. No. 103-354, Tit. II, § 232, 108 Stat. 3178 3
Ind. Code Ann. (Burns 1995):
§ 23-17-2-17 5
§ 23-17-2-18 5
§§ 23-17-7-1 *et seq.* 5
§ 28-17-19-1 19

Miscellaneous:

124 Cong. Rec. 32,408 (1978) 16-17
6A *Collier on Bankruptcy* (14th ed. 1977) 13-14
Henry J. Friendly, *Some Comments on the Corporate Reorganization Act*, 48 Harv. L. Rev. 39 (1934) 12
H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. 1 (1973) 17
H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977) 16, 17
Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L. J. 857 (1982) 11
Israel Packel, *The Organization and Operation of Cooperatives* (A.L.I. 1970) 19
S. Rep. No. 989, 95th Cong., 2d Sess. (1978) 17

In the Supreme Court of the United States

OCTOBER TERM, 1995

No.

IN THE MATTER OF WABASH VALLEY POWER ASSOCIATION, INC.

THE UNITED STATES OF AMERICA, ON BEHALF OF THE RURAL ELECTRIFICATION ADMINISTRATION, PETITIONER

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

The Acting Solicitor General, on behalf of the Rural Electrification Administration, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The panel opinion of the court of appeals (App. 1a-42a) is reported at 72 F.3d 1305. The order of the court of appeals (App. 229a-230a) denying the petition for rehearing is unreported. The opinions of the district court (App. 43a-57a) and the bankruptcy court (App. 58a-228a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 28, 1995. A petition for rehearing was denied and the court's opinion amended on April 2, 1996. App. 229-230a. On June 28, 1996, Justice Stevens extended the time in which to file a petition for a writ of certiorari to and including August 30, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 1129(b)(2)(B) of Title 11 provides, in pertinent part:

> For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
>
> * * * * *
>
> (B) With respect to a class of unsecured claims —
>
> (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
>
> (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

STATEMENT

1. Wabash Valley Power Association, Inc. (Wabash) is a not-for-profit electric cooperative organized under Indiana law. Wabash generates and purchases electricity, which it sells to its members, 24 rural electric membership cooperatives (REMCs) in Indiana, Michigan, and Ohio.[1] Wabash is managed by a board of 24 directors consisting of a director nominated from each of its REMC members. The 24 REMCs thus own and control Wabash, as well as purchase all of its electricity. The cooperative arrangement for buying and generating electricity through Wabash enables the REMCs to obtain electricity for resale without paying the generator any margin of profit. Their customer-members, in turn, benefit from lower prices.

As part of a long-term strategy to serve its REMC customer-members, Wabash agreed in the 1970s to invest in the construction of the Marble Hill nuclear power plant. The Public Service Company of Indiana (PSI) undertook to build the plant, with Wabash purchasing a 17% stake in Marble Hill financed by $ 486 million in loans guaranteed by the Rural Electrification Administration (REA), an agency of the Department of Agriculture.[2] REA guaranteed a further $ 184 million in loans to Wabash for electrical substations, power lines, and a generating plant

---

[1] Each REMC is also a cooperative, owned and managed by retail electricity customers.

[2] The Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994 transferred REA's functions to the Rural Utilities Service (RUS). Pub. L. No. 103-354, Tit. II, § 232, 108 Stat. 3219. For consistency, we will refer to the agency as REA throughout the petition.

unrelated to Marble Hill. Wabash borrowed additional funds from the National Rural Utilities Cooperative Finance Corporation (CFC), a private entity that supplements REA's financing programs. As collateral, Wabash granted REA and CFC security interests in all of its tangible and intangible assets, including all of Wabash's interests in, and all revenues deriving from, certain long-term supply contracts between Wabash and each of the 24 REMCs. Those contracts, which were executed by the REMCs to induce REA to guarantee the loans, bind the 24 REMCs to purchase all of their electricity from Wabash for a period of 40 years. See *In re Wabash Valley Power Ass'n*, 114 B.R. 613, 616-620 (S.D. Ind. 1990); *National Rural Utils. Coop. Fin. Corp.* v. *Wabash Valley Power Ass'n*, 111 B.R. 752, 772-773 (S.D. Ind. 1980).

The Marble Hill project ran into difficulties and was cancelled by PSI in January, 1984. Wabash requested a rate increase to repay its Marble Hill debt. The Indiana Utility Regulatory Commission (IURC) denied that request because Marble Hill was not "used or useful" in the production of electricity. The Indiana courts affirmed the IURC's ruling. *National Rural Utils. Coop. Fin. Corp.* v. *Public Serv. Comm'n of Ind.*, 552 N.E.2d 23, 26, 29 (Ind. 1990).[3]

Unable to service the substantial debts arising from the failed Marble Hill project, Wabash filed a

---

[3] REA's attempts to mandate a rate increase by means of federal preemption were also rejected by the courts. See *Wabash Valley Power Ass'n* v. *REA*, 903 F.2d 445 (7th Cir. 1990); *Wabash Valley Power Ass'n* v. *REA*, 988 F.2d 1480 (7th Cir. 1993).

petition under Chapter 11 of the Bankruptcy Code in May, 1985. It has operated ever since as a debtor-in-possession.

2. In 1990, Wabash proposed a Third Restated Fourth Amended Plan of Reorganization (Wabash Plan or Plan). Not counting post-petition interest (which exceeded $ 400 million), REA's claims at confirmation totalled approximately $ 670 million. The Wabash Plan would repay REA approximately $ 401.7 million of this debt. The Plan states that, upon confirmation, the interest of each REMC member in Wabash, if any,[4] "shall terminate." It further provides, however, that the current board of directors of Wabash—composed of nominees from each of the 24 member REMCs—will continue to control Wabash, and that Wabash's current officers will remain in place. The Plan was accepted by PSI and 21 of the 24 REMCs. It was rejected by REA and CFC, which hold more than 90% of the dollar value of claims against Wabash.[5] See 11 U.S.C. 1126(a).

3. REA argued in bankruptcy court that approval of the Wabash Plan was barred by the "absolute priority" rule codified in 11 U.S.C. 1129(b)(2)(B)(ii). That rule provides that junior claimants may not "receive or retain" "any property" "on account of" their claims if the claims of senior, dissenting creditors remain unsatisfied. The bankruptcy court rejected

---

[4] The Plan states that, as members of a not-for-profit corporation, the REMCs "do not possess the usual indicia associated with an equity security holder." C.A. App. 210. See Ind. Code Ann. §§ 23-17-2-17, 23-17-2-18, 23-17-7-1 *et seq.* (Burns 1995).

[5] REA proposed an alternative plan, which was rejected by PSI and all 24 REMCs. That plan is no longer at issue.

that contention and adopted in their entirety findings of fact and conclusions of law proposed by Wabash. App. 181a-200a.

The bankruptcy court concluded that the absolute priority rule did not apply for three reasons. First, the court held that the REMCs' right to control Wabash after confirmation derived from their rights under the long-term supply contracts, which were necessary to provide a future income stream for creditors such as REA, rather than from their position as "equity holders." Consequently, the bankruptcy court held that the REMCs do not receive or retain any property "on account of" their interests in Wabash under the Plan. App. 187a-189a, 199a-200a. Second, the court concluded that the principal concern underlying the absolute priority rule—to prevent equity holders (who have an opportunity to profit from the post-confirmation operations of the reorganized debtor) from retaining their interests at the expense of unsecured creditors—did not apply, because a non-profit, cooperatively-owned entity such as Wabash simply "cannot make a profit for the Members [the REMCs] at the expense of creditors" after confirmation of the Plan. *Ibid.* Finally, the court concluded that the $ 3.2 million "new capital" contributed by the REMCs satisfied the "new value" exception to the absolute priority rule, which the court stated was a "viable" and "essential" part of bankruptcy practice. *Id.* at 189a-200a. The court also thought that the Wabash Plan conferred the "greatest economic benefit" to REA and CFC since no better offer for Wabash's assets had been presented and, under the Plan, REA and CFC would receive more than Wabash's fair market value as a "going concern." *Id.* at 181a-186a. Based on that reasoning,

the bankruptcy court permitted the Plan to be "crammed down" as "fair and equitable" over REA's and CFC's objections. *Id.* at 59a-60a.

4. The district court affirmed. App. 43a-57a. It agreed with the bankruptcy court that the REMCs' retention of control of Wabash under the Plan did not violate the absolute priority rule, because their continued control was required by the supply contracts and the Plan "provides that the members' interest in any property of Wabash is cut off." *Id.* at 53a. The court also agreed that the reasons underlying the rule did not apply here since it was not possible for Wabash, a regulated not-for-profit corporation, "to profit from its Chapter 11 experience in the classic profiting sense of being able to make money and keep it for itself to do with as it wishes." *Id.* at 55a. The district court did not discuss whether the REMCs' contribution of $ 3.2 million satisfied the "new value" exception to the absolute priority rule.

5. The court of appeals affirmed. App. 1a-42a. Distinguishing *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197 (1988), the court concluded that continued REMC control of Wabash did not violate the absolute priority rule because Wabash, as a cooperative entity, does not generate "[a] share of profits" for its member-REMCs, an attribute the court thought was "essential" to application of the rule. App. 28a-29a. "The potential for lower rates [accruing to the REMCs from their cooperative arrangement] is simply not an interest cognizable in bankruptcy," the court stated, and "[c]ontrol alone, divorced from any right to share in corporate profits or assets, does not amount to an equity interest." *Ibid.* The court did not view that result as unfair, because REA was familiar with Wabash's cooperative

structure when it agreed to guarantee the loans. *Id.* at 30a-31a. The court also believed it unlikely that *the government would recover more money under any* alternative plan. *Id.* at 31a-32a. In light of its ruling, the court stated that it had no need to resolve whether a "new value" exception to the absolute priority rule survived the enactment of the 1978 Bankruptcy Code. *Id.* at 18a-20a.

REASONS FOR GRANTING THE PETITION

The absolute priority rule codified at 11 U.S.C. 1129(b)(2)(B)(ii) assures creditors the right to be paid in full before interest holders receive or retain any property of the debtor. See *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197 (1988). By creating an exception to the absolute priority rule for not-for-profit cooperatives, the court of appeals contravened this Court's holding in *Ahlers* that no judge-made exceptions to the absolute priority rule survived Congress's enactment of the Bankruptcy Code in 1978 (with the possible exception of the new value exception that the *Ahlers* Court and the court below declined to reach). See 485 U.S. at 206.[6]

---

[6] Although the court of appeals expressly stated that it was not applying the new value exception, it analyzed the relationships between the REMCs and Wabash in a manner that suggests such reasoning. See App. 28a. This Court has twice granted certiorari to decide whether a new value exception survived codification of the absolute priority rule in the 1978 Bankruptcy Code but both times has failed or been unable to reach the issue. See *U.S. Bancorp Mortgage Co.* v. *Bonner Mall Partnership*, 115 S. Ct. 386 (1994) (bankruptcy issue not decided because of mootness); *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197 (1988) (deciding that the Court need not reach the new value exception issue on facts presented). To the extent that the present case raises issues concerning the

The bases on which the court of appeals rested its decision conflict with decisions of this Court, the Tenth Circuit, and bankruptcy courts, and find no support in the language of the Bankruptcy Code. First, contrary to the court of appeals' ruling, retention of control by the debtor is a sufficient "interest" in "property" to require application of the absolute priority rule. This Court has stated that, if the debtor retains an interest "only for purposes of control," *Ahlers*, 485 U.S. at 208, the absolute priority rule applies and the reorganization plan must provide full value to creditors' claims. Second, the court of appeals' conclusion that receipt of "a share of corporate profits or assets" by junior interests is "essential" for application of the absolute priority rule is inconsistent with the Code and with all but one court decision to address the issue. The court's conclusion gives inadequate weight to the fact that Wabash's REMC members derive significant economic benefits from avoiding the profit margin on electricity rates.

The court's departure from recognized bankruptcy principles in this case is particularly significant for the United States. REA currently has nine troubled cooperative borrower systems, structured in a manner similar to Wabash, with outstanding REA loans and loan guarantees exceeding $ 10 billion. The decision of the court of appeals threatens REA's ability to recoup significant sums loaned to those cooperatives. More generally, the court's decision creates a roadmap for cooperatives to avoid the absolute priority rule to the detriment of creditors.

---

new value exception, we adhere to our position in *Ahlers* and *Bonner Mall* that the exception did not survive enactment of the 1978 Bankruptcy Code.

1.a. A plan of reorganization may be confirmed under the Bankrupcy Code only if: (1) every class of creditors is "not impaired"[7] under the plan; (2) every class of creditors has accepted the plan, 11 U.S.C. 1129(a)(8); or (3) the plan meets the requirements of Section 1129(b), which allows a plan to be imposed on an impaired, dissenting class of creditors if it is "fair and equitable." 11 U.S.C. 1129(b)(1). Since the interests of both REA and CFC are impaired under the Wabash Plan and neither has accepted the Plan, the Wabash Plan may not be confirmed unless it is "fair and equitable."

Section 1129(b) sets out the criteria that must be satisfied for a plan to be "fair and equitable" for these purposes. As relevant here, a plan is "fair and equitable" to a dissenting class of unsecured creditors only if each member of the class "receive[s] or retain[s] on account of [its] claim property of value, as of the effective date of the plan, equal to the allowed amount of such claim," *or*

> the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. 1129(b)(2)(B)(i) and (ii). That language codified the "absolute priority" rule. *Ahlers*, 485 U.S. at 202.[8] As paraphrased by the courts, "the absolute

---

[7] A claim is "impaired" for purposes of the Code unless, *inter alia*, the plan leaves "unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest." 11 U.S.C. 1124(a).

[8] The absolute priority rule had its genesis in the requirements of Chapter X of the former Bankruptcy Act of 1898 that a plan of reorganization could be confirmed only if it was "fair

priority rule 'provides that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization plan].'" *Ibid.*, quoting *In re Ahlers*, 794 F.2d 388, 401 (8th Cir. 1986).

b. The principle underlying the absolute priority rule is that, when an enterprise is insolvent, all of its assets are properly treated as owned by its creditors. See Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857, 894 (1982) ("Reorganization proceedings provide nothing more than a method by which the sale of an enterprise as a going concern may be made to the creditors themselves."). As this Court noted in *Ahlers*, the structure of the Bankruptcy Code permits creditors to determine what future use is made of the assets of the enterprise and to evaluate whether they are "better off" by leaving the assets in the reorganized enterprise or by liquidation. *Ahlers*, 485 U.S. at 206-207.[9] When the rule is violated, and

---

and equitable." See *Ahlers*, 485 U.S. at 202. In Justice Douglas' words, that phrase was intended to codify "the 'familiar rule' * * * that 'any arrangement of the parties by which the subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation.'" *Case* v. *Los Angeles Lumber Prod. Co.*, 308 U.S. 106, 116 (1939), quoting *Louisville Trust Co.* v. *Louisville, N.A. & C. Ry.*, 174 U.S. 674, 684 (1899).

[9] The court of appeals improperly speculated that the government would be better off under the Wabash Plan than under other alternatives. As this Court made clear in *Ahlers*, "the Code provides that it is up to the creditors—and not the courts—to accept or reject a reorganization plan which * * * fails to honor the absolute priority rule." *Ahlers*, 485 U.S. at 207. The determination whether creditors are "better off" if

creditors are forced to accept continued control and/or use of the assets by lesser interests, the result is unfair to creditors. See Henry J. Friendly, *Some Comments on the Corporate Reorganizations Act*, 48 Harv. L. Rev. 39, 77-78 (1934). By creating a new exception to the rule for debts owed by cooperative business entities, the court below has dramatically and improperly shifted the balance between debtor and creditor in bankruptcy proceedings concerning such entities.

c. Under the Wabash Plan, REA holds a substantial unsecured claim against Wabash that will not be satisfied in full,[10] yet the 24 member REMCs will remain in control of the reorganized debtor. The court of appeals upheld that result, because (in the court's view) the absolute priority rule applies only to enterprises that generate a "profit" in the conventional sense of a return on investment or a right to share in assets upon dissolution. See App. 28a-30a.[11]

d. That holding creates a new exception to the absolute priority rule in contravention to this Court's admonition in *Ahlers* that no new exceptions will be recognized to that rule under the 1978 Bankruptcy Code. In *Ahlers*, the Court granted certiorari to

---

the plan is confirmed "is for the creditors to make in the manner specified by the Code" and "courts applying the Code must effectuate their decision." *Ibid.*

[10] Thus, the first clause of Section 1129(b)(2)(B) is inapplicable to this case.

[11] The court also reasoned, App. 30a-31a, that continued REMC control of Wabash was not unfair because REA was familiar with Wabash's structure at the time it guaranteed these loans. REA, however, cannot be charged with anticipating the court of appeals' departure from the absolute priority rule.

decide whether an exception existed to the absolute priority rule for "new value" contributed by the debtor. Courts had interpreted this Court's decision in *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), to recognize such an exception. Although it ultimately reserved judgment on whether the "new value" exception of *Case* survived the enactment of the Code, see 485 U.S. at 203-204 n.3, the *Ahlers* Court unanimously rejected the suggestion that there are any *other* exceptions to the rule. The respondents in *Ahlers* had urged the Court to find a "broader exception" to the rule in that case, even though the *Case* exception was inapplicable. Canvassing the legislative history of the Bankruptcy Code, this Court concluded that "no such broader exception exists":

> We think the statutory language and the legislative history of § 1129(b) clearly bar *any* expansion of *any* exception to the absolute priority rule beyond that recognized in our cases at the time Congress enacted the 1978 Bankruptcy Code.

485 U.S. at 205-206 (emphasis added).[12] We know of no case before enactment of the Bankruptcy Code in 1978 that created an exception to the absolute priority rule of the type recognized by the court of appeals in this case.[13]

---

[12] The Court in *Ahlers* reserved judgment on whether the "new value" exception to the absolute priority rule of *Case* survived enactment of the Code, see 485 U.S. at 203 n.3.

[13] See *In re Stegall*, 85 B.R. 510, 513 (C.D. Ill. 1987) (noting that "courts have recognized one exception to the absolute priority rule through which an individual owner may retain an interest in the debtor estate," the new value exception), aff'd, 865 F.2d 140 (7th Cir. 1989). See also 6A *Collier on Bankruptcy*

2. In creating an exception to the absolute priority rule for businesses owned in a cooperative arrangement, the court of appeals' reasoning conflicts with the statute and applicable case law in at least two ways.

a. The court of appeals held that "[c]ontrol alone, divorced from any right to share in corporate profits or assets, does not amount to an equity interest." App. 29a. That ruling conflicts both with this Court's decision in *Ahlers* and the Tenth Circuit's analysis of "interest" in *Unruh* v. *Rushville State Bank*, 987 F.2d 1506 (1993).

In *Ahlers*, this Court held that retained control over an enterprise is sufficient to create an "interest" under the absolute priority rule. As the Court noted, even "where 'going concern' value may be minimal, there may still be some value in the control of the enterprise." 485 U.S. at 208. *Ahlers* did not apply the absolute priority rule in a novel way; the Court derived support for its ruling from a 1913 decision of this Court: "Whether the value is 'present or prospective, for dividends *or only for purposes of control*' a retained equity interest is a property interest to 'which creditors [are] entitled . . . before the stockholders [can] retain it for any purpose whatever.'" *Ibid.* (emphasis added), quoting *Northern Pacific Ry.* v. *Boyd*, 228 U.S. 482, 508 (1913). As the *Ahlers* Court concluded, "we think that the interest [debtors] would retain under any reorganization must be considered 'property' under § 1129(b)(2)(B)(ii), and therefore can only be retained pursuant to a plan

---

¶ 11.06 (14th ed. 1977) (canvassing cases under pre-Code absolute priority rule).

accepted by their creditors or formulated in compliance with the absolute priority rule." 485 U.S. at 209.

In *Unruh*, the debtors operated farms as sole proprietorships. Under their plan of reorganization, they sought to retain managerial control over the farms, which had negligible value as going concerns. The debtors argued that the absolute priority rule did not operate to deny them control over their land since its minuscule value did not constitute an "interest" in "property" for purposes of 11 U.S.C. 1129(b)(2)(B)(ii). The Tenth Circuit rejected that argument. The court emphasized that, because the debtors were "retaining control of their farms and the rights to future profits," they were "receiving property within the meaning of the rule." 987 F.2d at 1509 (citing *Ahlers*, 485 U.S. at 207-208).[14]

b. The court of appeals' conclusion that the absolute priority rule is inapplicable to cooperative commercial entities proceeds from its erroneous assumption that the rules of bankruptcy distribution are only concerned with property "interests" that result in a "profit" in the conventional sense of a return on investment or a right to share in assets upon dissolution. The court held that the interest of Wabash's members in their cooperative, giving them the benefit of lower prices, "is simply not * * * cognizable in bankruptcy." See App. 15a-17a, 28a-30a.[15]

---

[14] Although the *Unruh* court accepted that, as an economic entity, the farm had "no value," it appeared to recognize that control over the farm gave the debtor the opportunity for future economic benefits. In that respect as well, the Tenth Circuit's approach differs from that of the court below. See 987 F.2d at 1509.

[15] Both the bankruptcy court and the district court expressed similar sentiments. See App. 187a-189a, 200a, 55a.

Nothing in the language of the Code supports the court of appeals' distinction between profit-making and cooperative commercial enterprises for purposes of the absolute priority rule.[16] The Code's statement of the rule is unequivocal: A plan is "fair and equitable" to unsecured creditors *only* if "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. 1129(b)(2)(B)(ii).[17] This language

---

[16] A "debtor" for purposes of Chapter 11 must be a "person," which includes "corporation[s]." 11 U.S.C. 101(13) and (41), 109(d). A corporation is defined to include associations having the power or privileges of private corporations and unincorporated companies or associations. 11 U.S.C. 101(9). This definition was intended to encompass entities covered under the old Bankruptcy Act. H.R. Rep. No. 595, 95th Cong., 1st Sess. 309-310 (1977); S. Rep. No. 989, 95th Cong., 2d Sess. 22-23 (1978). See *In re Allen University*, 497 F.2d 346 (4th Cir. 1974) (non-profit institution can be a voluntary bankrupt under Chapter X of the former Bankruptcy Act).

[17] Although we think the language is clear and resort to legislative history is unnecessary, see *Toibb* v. *Radloff*, 501 U.S. at 162, nothing in that history suggests special treatment for cooperative entities in bankruptcy. The House Report explains that Section 1129(b)(2)(B)(ii) was intended to "codif[y] the absolute priority rule from the dissenting class on down" and goes on to recite the rule without suggesting any exceptions or qualifications:

> The general principle of the subsection permits confirmation notwithstanding non-acceptance by an impaired class if that class and all below it in priority are treated according to the absolute priority rule. The dissenting class must be paid in full before any junior class may share under the plan.

H.R. Rep. No. 595, *supra*, at 413. Other legislative history suggests a similarly broad, unqualified rule. See 124 Cong.

provides no basis for distinguishing between profit-making and cooperative business enterprises.[18]

The court of appeals' creation of an exception to the absolute priority rule for entities such as Wabash is unsupported by the case law, which almost universally subjects not-for-profit entities to the same requirements for confirmation under Section 1129(b) as profit-making enterprises. See, *e.g.*, *In re S.A.B.T.C. Townhouse Ass'n*, 152 B.R. 1005 (Bankr. M.D. Fla. 1993) (absolute priority rule applicable to nonprofit homeowners association); *In re E. Maine Elec. Coop.*, 125 B.R. 329 (Bankr. D. Me. 1991) (rule applicable to not-for-profit electric cooperative); *In re Mandalay Shores Coop. Housing Ass'n*, 53 B.R. 609 (Bankr. M.D. Fla. 1985) (rule applicable to nonprofit cooperative association). But see *In re Whittaker Memorial Hosp. Ass'n*, 149 B.R. 812 (Bankr. E.D. Va.

Rec. 32,408 (1978) (Rep. Edwards) ("the plan may be confirmed if the impaired class of unsecured claims receives less than 100 cents on the dollar (or nothing at all) as long as no class junior to the dissenting class receives anything at all"). See also H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. 1, at 258-259 (1973).

[18] Other provisions of the Code support this reading. Congress provided in the Code that a bankruptcy case may not be converted from a reorganization to a liquidation if the debtor is "a corporation that is not a moneyed, business, or commercial corporation." 11 U.S.C. 1112(c). Congress thus provided special rules for not-for-profit entities in bankruptcy in specific instances. Its failure to do so here strongly suggests that no such exception was intended. See, *e.g.*, *City of Chicago* v. *Environmental Defense Fund*, 114 S. Ct. 1588, 1593 (1994) ("'[I]t is generally presumed that Congress acts intentionally and purposely' when it 'includes particular language in one section of a statute but omits it in another.'"); *Russello* v. *United States*, 464 U.S. 16, 23 (1983) (same).

1993) (rule inapplicable to nonstock membership hospital corporation).

There is no sound basis for creating an exception to the absolute priority rule for cooperative commercial entities. A cooperative electric utility company seeks to obtain lower prices for its members by eliminating costs associated with the generators' "profit" or "return on equity." See App. 15a-17a. That does not mean that the members lack economic self-interest or that the financial benefits accruing to the cooperative's membership are "not an interest cognizable in bankruptcy," as the court of appeals held. *Id.* at 28a. Just as with for-profit corporations and partnerships, cooperatives are economic institutions whose "primary objective * * * is not charitable." Israel Packel, *The Organization and Operation of Cooperatives* 7 (A.L.I. 1970). "In the normal case * * * the cooperative is designed to further the economic welfare of its members." *Ibid.* The court below acknowledged the valuable economic benefits flowing to Wabash's members under the Plan, but rationalized the nonpayment of REA debts as follows:

> The absolute priority rule is an aspect of the requirement that a plan be "fair and equitable." There is some appearance of unfairness in the Wabash Plan. Wabash's member distribution cooperatives, whose representatives approved the Marble Hill fiasco, emerge from bankruptcy in the driver's seat, still paying low rates, and still not paying off the REA debt. *This outcome, however, is justified, even dictated, by Wabash's cooperative structure. The Members, by controlling Wabash, control their own rates, making it possible*

> *for them to be served under the 40-year requirements contracts, which are, in turn, Wabash's most valuable possession.*

App. 27a (emphasis added).

Moreover, nothing in state law would prevent a cooperative, after avoiding its debt to the United States through the lower courts' creation of a cooperative enterprise exception to the absolute priority rule, from emerging from bankruptcy and converting into a for-profit entity. See, *e.g.*, Ind. Code Ann. § 23-17-19-1 (Burns 1995) (permitting not-for-profit entity to merge with business corporation). There is no justification for applying the absolute priority rule differently with regard to two essentially fungible forms of doing business.

3. The court of appeals' departure from recognized bankruptcy principles in this case is particularly significant for the United States because electric utility cooperatives constitute the vast majority of the entities to which REA extends loans under its program to assist in the provision of rural electric power. *E.g.*, *In re E. Maine Elec. Coop.*, 125 B.R. 329 (Bankr. D. Maine 1991). The decision of the court of appeals provides a roadmap for these entities to abandon their debt to the United States, while remaining in control of and retaining all of the economic benefits of their enterprises. REA currently has nine troubled cooperative borrower systems with outstanding REA loans and loan guarantees exceeding $ 10 billion.

The court of appeals' ruling also poses a significant threat, beyond the circumstances of REA loans to troubled electric cooperatives, to the legitimate interests and expectations of creditors. The grava-

men of the court of appeals' holding is that a cooperative entity can retain control over its future activities and enjoy the benefits of its operations without being wholly accountable to creditors through application of the absolute priority rule. That ruling may be invoked by entities previously thought to have been included within the ambit of the absolute priority rule, such as cooperative housing associations, *e.g.*, *In re Mandalay Shores Coop. Housing Ass'n*, 53 B.R. 609 (Bankr. M.D. Fla. 1985) (applying absolute priority rule); homeowners' associations, *e.g.*, *In re S.A.B.T.C. Townhouse Ass'n*, 152 B.R. 1005 (Bankr. M.D. Fla. 1993) (same); and nonprofit hospital associations that own and control hospitals, but see, *e.g.*, *In re Whittaker Memorial Hosp. Ass'n*, 149 B.R. 812 (Bankr. E.D. Va. 1993) (creating exception to absolute priority rule).

Other nonprofit entities, such as nursing homes, insurance companies, associations of condominium owners, trusts to pay health care expenses, and associations to manage low-income housing, could also conceivably invoke the exception recognized by the court of appeals.[19] There is no logical basis for distinguishing any of these economic entities from those normally subject to application of the absolute priority rule, especially when the entities are

---

[19] All of these types of not-for-profit entities have sought protection under the Bankruptcy Code. See, *e.g.*, *In re Lummus Indus., Inc.*, 193 B.R. 615 (Bankr. M.D. Ga. 1996); *In re Lincoln Avenue & Crawford's Home for the Aged, Inc.*, 164 B.R. 600 (Bankr. S.D. Ohio 1994); *In re 560 Ocean Club, L.P.*, 133 B.R. 310 (Bankr. D.N.J. 1991); *In re Westchester County Civil Serv. Employees Ass'n*, 111 B.R. 451 (Bankr. S.D.N.Y. 1990); *In re Two-KMF Dev. Ass'n*, 63 B.R. 149 (Bankr. N.D. Ill. 1985).

organized to advance economic, if not strictly "profit"-making, interests. The rights of creditors to the important protection of the absolute priority rule should not turn on the form of business organization chosen by the debtor.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

WALTER DELLINGER
Acting Solicitor General
FRANK W. HUNGER
Assistant Attorney General
PAUL BENDER
Deputy Solicitor General
DAVID C. FREDERICK
Assistant to the Solicitor General
WILLIAM KANTER
JOHN P. SCHNITKER
JOHN T. STEMPLEWICZ
Attorneys

AUGUST 1996